

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of James Madaffer on April 27, 2006

DATED: May 22, 2006

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On April 27, 2006, Benito Romano and Michael Schachter, in Willkie Farr & Gallagher LLP's capacity as Counsel to the Audit Committee, and Lynn Turner of the Audit Committee, interviewed Councilmember James Madaffer. Councilmember Madaffer was represented during this interview by his lawyer, Thomas Zaccaro, of Paul, Hastings, Janofsky & Walker LLP. Also present were William Haegele and Donielle Evans of KPMG, and Ray Sarola of Willkie. This interview took place in a conference room on the 3rd floor of the City Administration Building in San Diego and lasted approximately five and one-half hours.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Councilmember Madaffer, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

#### *Warnings*

Mr. Romano explained that he did not represent Councilmember Madaffer, but represented an Audit Committee established by resolution of the City of San Diego City Council to conduct an investigation of the City's pension deficit and related matters. In the course of conducting that investigation, interviews taken and summaries created will be treated as confidential under the attorney client privilege and work product doctrine, but the investigation will result in a public report, which in all likelihood will cause the loss of such confidentiality. In addition, apart from public disclosure resulting in the loss of such privilege, Mr. Romano advised that there are several government investigations by federal and local law enforcement authorities with whom the Audit Committee is cooperating; thus, Mr. Romano advised, it was important for Councilmember Madaffer to be accurate in his responses to questions during his interview. Mr. Romano stated that he would rephrase any question that Councilmember Madaffer did not understand.

Mr. Madaffer asked Mr. Romano whether his questions would invade the City's attorney-client privilege. Mr. Romano observed, in response, that the City Council has adopted a Resolution in which it waived certain privileges related to subject matters covered by documents produced to the SEC and the United States Attorney, and these topics will be discussed in this interview. Mr. Romano noted that he spoke with the federal prosecutor and learned that the City had produced Closed Session materials to the government.

Mr. Romano told Councilmember Madaffer that he could speak to his attorney at any time and that no inferences would be drawn from such communications. Mr. Romano also told Councilmember Madaffer that he had read the summaries of Mr. Madaffer's prior interviews with Vinson & Elkins and Navigant.

### ***Background***

Mr. Romano began the interview by asking Councilmember Madaffer to explain his education and employment history. Mr. Madaffer stated that he attended but did not graduate from San Diego State University. He described himself as a entrepreneur, businessman and community activist, and noted that he is also a pilot and scuba diver. Councilmember Madaffer began his business career in 1981, working as a manufacturer of jacuzzi covers. He sold this business in 1987 and started a business making card decks, until he began his involvement in civic affairs, where he was a "citizen volunteer" for various boards and commissions. He continued to volunteer with community groups until he was hired in 1993 to be Councilmember Judy McCarty's Chief of Staff, a position he held until 2000.

### ***Introduction to Pension Issues***

Mr. Romano asked Councilmember Madaffer to describe his understanding of corridor funding during the years 1993 to 2000, and Councilmember Madaffer responded that he had "zero understanding" of the issue at that time. Councilmember Madaffer stated that he did not understand the specifics of the pension system, and his only exposure during this time period was once or twice a year when he would vote for the employee representative on the pension board. Mr. Romano asked if he had assigned to any of Councilmember McCarty's staff the responsibility for pension issues and Councilmember Madaffer responded that he did not assign staff to cover this issue since "it did very well in its own little world." He noted that it was not until 2002 that he began to understand the nuances of the pension system.

Later in the interview, Mr. Turner asked if Councilmember McCarty had ever discussed MP1 with him in 1996, or whether he saw any materials related to MP1 around that time. Councilmember Madaffer replied that he had no discussions and saw no materials on this topic. He stated that the Blue Ribbon Committee ("BRC") report was the first he had heard of the shortfall and that Councilmember McCarty's only involvement with the pension system was her knowledge that it was doing well. Mr. Turner asked Councilmember Madaffer to describe his responsibilities in Councilmember McCarty's office and Councilmember Madaffer replied that he ran the office, docket, and policy issues. Mr. Turner asked if he would have been aware that MP1 was on the docket, and Councilmember Madaffer explained that he would not have been aware if it was only dealt with in Closed Session. Although currently Closed Session items are posted on a public agenda, at that time they were not. The practice of noticing Closed Session items came out of the V&E Report, as a way to give the public an opportunity to be heard on these items. Councilmember Madaffer expressed his view that this remediation has worked well.

Mr. Romano asked whether pension funding was an issue during Councilmember Madaffer's first campaign. Councilmember Madaffer replied that the Chargers ticket guarantee and the Padres' ballpark were the main issues and that pension funding was not. In response to a question as to whether Mayor Murphy had announced that he wanted a review of the pension

system during his 1999 campaign, Councilmember Madaffer stated that he thought that was during the Mayor's re-election campaign in 2004. He stated again that the Chargers and Padres were the "issues of the day," and that the ballpark project had been stalled due to a conflict issue with Councilmember Stallings. Councilmember Madaffer stated that Councilmember Stallings had received an unreported gift from the Padres owner and was found to have violated Government Code Section 1090.

### ***Blue Ribbon Committee***

Moving to the next topic, Mr. Romano asked Councilmember Madaffer if he recalled the Mayor's Blue Ribbon Committee and Councilmember Madaffer responded that he did. Councilmember Madaffer stated that the Mayor announced the formation of the BRC because he was interested in getting an assessment of the fiscal condition of the City due to a desire to improve the library, the ballpark, and Balboa Park.

Mr. Romano asked Councilmember Madaffer to describe his relationship with the Mayor at that time, and asked whether Councilmember Madaffer was in the Mayor's inner circle with regards to these decisions. Councilmember Madaffer responded that he was in the Mayor's inner circle, and had known Mayor Murphy since the time he was a Councilmember in Councilmember Madaffer's district. In 1985, Mayor Murphy was appointed to be a municipal judge, and Mr. Madaffer spoke with John Kern, the Chief of Staff to then-Councilmember Murphy, and asked him to set up a meeting because Mr. Madaffer wanted to run for this seat. Then-Councilmember Murphy told Mr. Madaffer that he had Judy McCarty in mind as his successor, and told him to get involved with her campaign.

Returning to the BRC, Mr. Romano inquired whether Councilmember Madaffer was involved in the selection of the BRC's members, and Councilmember Madaffer did not recall if he was. Mr. Romano then asked if he knew Richard Vortmann at the time, and Councilmember Madaffer responded that he had heard Mr. Vortmann's name with regards to development issues. Mr. Romano asked whether, at the time, Councilmember Madaffer had a sense of how long the BRC would take to conclude its assignment. Councilmember Madaffer replied that he didn't recall how long the Council thought it would take, but that it was not "supposed to take forever." He explained that it is typical in government to appoint a committee for a specific task, and when that committee writes a report, the process is concluded. Mr. Romano asked whether Councilmember Madaffer had a sense that the report was delayed and he responded that he did not have that sense. Mr. Romano then asked if he thought the BRC concluded promptly and Councilmember Madaffer stated that he did not recall if the report was delayed or prompt, but did recall that it was issued about a year after the BRC was announced. Mr. Romano then asked if there were any concerns on the part of Councilmembers about the length of time the Committee took to issue its report. Councilmember Madaffer replied that Councilmembers did not have this concern, and the BRC was something Mayor Murphy had implemented to acquire third-party validation of the financial information he was being told from within the City. According to Councilmember Madaffer, the Mayor wanted to find out whether the information he was being told from City sources was accurate.

Mr. Romano asked if Councilmember Madaffer recalled the presentation of the BRC Report to the Rules Committee, and Councilmember Madaffer responded that he did. Mr. Romano asked if his reaction to this presentation was one of shock, and Councilmember Madaffer

replied that it was. In general, Councilmember Madaffer believed the BRC Report stated that San Diego was a good city, but he was shocked to hear that the pension was \$6 or \$7 million underfunded. Councilmember Madaffer noted that in the private sector, if he was an owner who didn't make his payroll tax, he would have heard about it instantly. Councilmember Madaffer stated that this was the first he ever heard about the City willfully underfunding the pension system. Mr. Romano asked why he used the term "willfully," and Councilmember Madaffer stated that it was obvious that the City was underfunding the pension and "inquiring minds wanted to know why." Mr. Romano stated that the transcript of the Rules Committee meeting reflects that the system was "intentionally backloaded," but Councilmember Madaffer could not say if that was consistent with his recollection.

Mr. Romano stated that he understood it can be difficult to distinguish your impressions at the time from after-acquired information and beliefs, but asked Councilmember Madaffer if he could describe his understanding of the implications of the BRC Report at the time he heard them. Councilmember Madaffer described himself as "livid" in reaction to the Report, and he stated that he wanted the City Manager to address these issues. The Rules Committee agreed and asked the City Manager for a justification for the \$6 or \$7 million shortfall.

Mr. Romano asked if the shock he felt at the time was shared by other Councilmembers. Councilmember Madaffer stated that he was not sure if others shared his shock because Councilmembers generally did not discuss what went on in Council meetings outside of those meetings, though this practice has been different lately. Councilmember Madaffer believed that he spoke first at this meeting and "was not happy."

Mr. Romano asked if Councilmember Madaffer had seen a connection between underfunding and the pension benefits the City granted its workers at any time before MP2. Councilmember Madaffer responded that he did not see such a connection and did not even know about MP1 until later in 2002. Councilmember Madaffer explained that heading into the Meet & Confer process in May 2002, he felt satisfied that the City Manager was going to find a way to address the pension issues raised by the BRC. It was in discussions relating to pension issues around this time that Councilmember Madaffer first heard of MP1. Mr. Romano asked if he saw a proposal from the City Manager during the 2002 Meet & Confer meetings regarding the pension funding shortfall, and Councilmember Madaffer stated that he heard about the City Manager's response in a Closed Session meeting during this time.

Mr. Romano then asked if Councilmember Madaffer was aware at that time of any concerns expressed by the BRC about the content and tone of its report. He responded that he is now familiar with such concerns, but at the time all the information that the Council received was in the public domain and the Council's only contact with the BRC was in public meetings.

Mr. Romano asked whether the Ballpark financing was occurring around the time the BRC Report was issued, and Councilmember Madaffer replied that it was. Mr. Romano asked if he was aware of any concerns that Mr. Vortmann may have had about the effect the BRC Report might have had on the ballpark financing. Councilmember Madaffer responded that he was not aware of any such concerns; he knew only that Mr. Vortmann had reservations about press accounts, but noted that he was not made privy to Mr. Vortmann's personal concerns. Mr.

Romano asked if anyone from the City Manager's Office approached Councilmember Madaffer regarding the effect of the BRC Report on the City's credit rating, and Councilmember Madaffer responded that he had received no such communication and that the BRC Report seemed "manageable" at the time.

Mr. Romano asked a series of questions about which City agency was responsible for responding to the BRC pension issues, and Councilmember Madaffer responded that the City Manager was asked to report back to the Council. He did not recall if these issues were referred to SDCERS. Mr. Romano asked if the City Manager ever reported back to the Council and Councilmember Madaffer did not remember if he did. Councilmember Madaffer explained that it was his understanding that a month or two after the Rules Committee presentation, the pension shortfall issue came up again in the context of Meet & Confer. He stated that it was not until after MP2, in February or March 2003, when the SDCERS Board responded to the BRC.

Councilmember Madaffer was shown a memorandum from Mayor Murphy to the City Council dated April 4, 2002, regarding the Rules Committee's responses to the BRC's recommendations (Exhibit 1). Mr. Romano noted that Recommendations #2 and #3 of the BRC Report were referred to the SDCERS Board, and asked Councilmember Madaffer why this action was taken. Councilmember Madaffer did not know why these recommendations were referred to the SDCERS Board, and noted that at that time he did not even know about MP1. Councilmember Madaffer had come to know since then that these were City management issues, not retirement board issues, but had always felt that it was important to get answers to the questions the BRC raised. Mr. Romano asked whether anyone considered at the time the possibility that a City entity other than the SDCERS Board would be better equipped to handle the BRC recommendations, and Councilmember Madaffer responded that he always felt that the Council would receive information from the City Manager's Office. Mr. Romano asked if referring the BRC recommendations to the retirement board was the best way to resolve them, and Councilmember Madaffer replied that it was not. Mr. Romano then asked if Councilmember Madaffer thought referring these recommendations to the retirement board was an effort to slow down the City's response, and Councilmember Madaffer replied that he did not think so. He stated that it would be hard to conclude that these steps were taken to slow down the process, and could not imagine that it was done intentionally to delay a response.

Councilmember Madaffer was then shown a PowerPoint presentation dated February 6, 2003, titled "San Diego City Employees Retirement System: Report on the Mayor's Blue Ribbon Committee on City Finances" (Exhibit 2). Councilmember Madaffer stated that he remembered this presentation by the SDCERS Board to the Council in 2003. He recalled thinking that the retirement system was not in as bad shape as some people thought, and that of the \$1.5 or \$2 billion number, the only real concern was the \$720 million amount because the other amounts were contingent and not required to be paid. He remembered being told that the \$720 million shortfall was due to investment losses, and had repeated this statement to others.

Mr. Romano then asked Councilmember Madaffer if he thought that the SDCERS Board was making this presentation on its own or with the help of the City Manager. Councilmember Madaffer responded that the SDCERS Board made the presentation. Mr. Romano asked if the 77.3% funding ratio that appears on page 9 drew any attention during the meeting. Councilmember Madaffer responded that it did not, and that he did not know what a funding ratio meant at the time. Mr. Romano asked whether there was concern that the 77.3%

number was below the "trigger," and Councilmember Madaffer stated that the Council was primarily concerned with the unfunded liability. Mr. Romano asked if Councilmember Madaffer ever asked anyone to explain the pension presentation to him, and he responded that he did not and that he is not a pension expert.

### *Pension Reform Committee*

Mr. Romano asked if Councilmember Madaffer recalled action by the Council to create the Pension Reform Committee ("PRC"), and he responded that he did. The PRC was formed to look at the nuances of the pension fund from a fiscal standpoint. He noted that the Council appointed "a heady group of people" to the PRC. Mr. Romano asked if Councilmember Madaffer knew who thought of the idea to appoint such a group, and Councilmember Madaffer thought it was the Mayor, and that the PRC was established because of a sense that experts needed to address this issue.

Mr. Romano then handed Councilmember Madaffer a copy of the PRC's Minority Report, written by Mr. Vortmann (Exhibit 3). Mr. Romano asked whether Councilmember Madaffer remembered a hearing where the PRC Report was discussed. Councilmember Madaffer remembered this hearing and recalled that the need to full fund the system on an annual basis was discussed. There was a discussion of the need to make up the shortfall from 1996, and that an amortization schedule was provided that could accomplish this task. Mr. Romano asked about the reasons listed on page 27 and 28 of the PRC Report for the shortfall and noted that the PRC Report attributed 6% of the shortfall to investment losses. Councilmember Madaffer did not recall conversations in which this number was questioned, but stated that it was the opposite of what he was told by the SDCERS Board, who told him that the shortfall was primarily due to investment losses. Mr. Romano asked whether Councilmember Madaffer understood what was meant by "actuarial losses," and he replied that he did not know and no one ever tried to explain this to him. Mr. Romano asked Councilmember Madaffer for his understanding of the current status of these proposals, and Councilmember Madaffer replied that Mayor Jerry Sanders is moving forward with them.

Mr. Turner asked if Councilmember Madaffer remembered other Councilmembers requesting reports on the status of the implementation of these recommendations. He responded that he did not recall any requests specific to the pension issues or any single discussion regarding implementation of the PRC recommendations specifically, but if one were to take the PRC Report in pieces, there were probably requests made for updates. Councilmember Madaffer then mentioned amortization and Pension Obligation Bonds ("POB") as two areas on which the City is "moving forward." He remembered discussing these issues with April Boling (member of the BRC and PRC) and recalled concluding that he did not want to see a continued practice of underfunding, from political or policy standpoints.

Mr. Romano asked about a statement in the PRC Report that benefit improvements were the largest contributor to underfunding and specifically about the role of retroactive benefits. Councilmember Madaffer responded that prospective increases were probably negligible; the "biggest hit" was the retroactive increase. Mr. Romano asked if the PRC Report was the first time that Councilmember Madaffer had become aware of the impact of the benefits granted on the pension problem, and Councilmember Madaffer responded that it was not, and that he questioned the accuracy of these numbers. Mr. Turner asked why he would

question these numbers, and Councilmember Madaffer responded that he had been shown so many numbers that he did not know what they meant. For example, he noted that investment returns are stated to be 6%, but he did not know over what time period this was measured. He stated that reports have concluded that San Diego had one of the highest performing pensions over time, but that "you can use numbers to tell you anything."

Mr. Romano asked if the Council had determined to forward the PRC Report to any other body for further action, or if the Council was satisfied that this analysis was accurate. Councilmember Madaffer responded that he took the report at face value. He stated that it was important for the City to validate its financial information and now the City has its own actuary to verify the pension actuary. He believes that the benefits are legal and that case law supports this conclusion, but City Attorney Michael Aguirre is "making noise in a sandbox." Since the City is paying what they should be paying every year and catching up for the shortfall, Councilmember Madaffer believed that the problem was more political than financial. Mr. Turner asked him what he meant by this comment, and Councilmember Madaffer replied that there is a solution to the problem in POB's, but there is still a lot of talk about the issue. Mr. Turner noted that POB's create funding and a corresponding liability, but Councilmember Madaffer responded that if the City can borrow at less than 8% interest, he is satisfied. Mr. Turner asked if this solves the City's underfunding problem, and Councilmember Madaffer stated that they are trying to get back to 85% funded, and if the City can make its current payments and get back to 85% funded, this should be sufficient. He noted that pension is a cost that extends into the future, and he did not know what else he could do to address the issue other than paying the annual contribution and reducing any shortfall.

### *Surplus Earnings*

Mr. Romano asked Councilmember Madaffer about the concept of "surplus earnings," and he responded that he did not know who created this concept and stated that for him, there were no "surplus earnings." Mr. Romano asked if Councilmember Madaffer had an understanding of surplus earnings from his early days as a Council staffer. Councilmember Madaffer replied that he did not understand this concept and had little knowledge of pension issues other than that some SDCERS Board members were appointed by the Council. He did not know what "waterfall" and "surplus earnings" meant, and did not find out until the PRC or until he learned about MP1. Mr. Romano asked if he had a sense in the mid-1990s that there was a change in funding and he replied that he did not know this, and was surprised when he found out. Councilmember Madaffer noted that MP1 would have been discussed in Closed Session and that staff were prohibited by the Municipal Code from being involved in Closed Session issues.

Mr. Romano asked about the justification for Closed Session meetings, and Councilmember Madaffer responded that they are held when the financial interests of the City may be impaired by an adversary. Councilmember Madaffer had recently challenged a decision to discuss an issue in Closed Session, but the City Attorney's Office had insisted that it be dealt with in Closed Session.

### *Meet & Confer and MP2*

Mr. Romano asked Councilmember Madaffer to explain the circumstances surrounding his discovery of MP1. Councilmember Madaffer explained that during the March to

June 2002 timeframe he learned that the City had made guarantees and representations to the pension system and the question arose whether the City was going to continue to honor them. He noted that this arrangement was not known as "MP1" at that time. Mr. Romano noted that Meet & Confer dealt with benefits and salaries and asked how he learned about MP1 at this time. Councilmember Madaffer explained that Meet & Confer was where the Council learned about how the City was addressing problems with the pension system. He noted that the Council had mostly new members in 2002, who had been on the Council for less than two years. This was their first Meet & Confer and so they were given a carefully stated report of the pension system and solution to the underfunding, which was MP2. Councilmember Madaffer stated that MP2 doubled the City's contribution, but Mr. Turner replied that it doubled the annual increase, not the contribution itself. Mr. Romano asked whether Councilmember Madaffer thought that MP2 and the increased pension benefits were contingent, and he responded that he did not think they were and that MP2 was just a way for the City to solve the pension problem.

Councilmember Madaffer was shown a memorandum from Cathy Lexin (Human Resources Director), and Elmer Heap (Head Deputy City Attorney), dated June 14, 2002, concerning Meet & Confer and "Contingent Retirement Benefits" (Exhibit 4). Councilmember Madaffer read the memorandum and commented that the "several unpredictable events" it referred to were probably 9/11 and the stock market. Mr. Romano asked if he recalled receiving this document, and Councilmember Madaffer replied that he did. Mr. Romano then asked if he recalled knowing that benefits were contingent on the SDCERS Board's approval of contribution modification. Councilmember Madaffer could not say for sure, and stated that it depended on the meaning of "contingent." Mr. Romano asked him what contingency he understood to be present, and Councilmember Madaffer replied that the City needed to go to .5% and he connected this with the City's increase of benefits. Mr. Romano told Councilmember Madaffer to re-read the first paragraph and asked if it helped him remember the contingency that was present. Councilmember Madaffer replied that he recognized what was written, but he didn't understand what it was referring to as "contingent." Mr. Romano asked if he understood at the time that the City could offer benefit increases unconditionally. Councilmember Madaffer replied that, put that way, he did not think the City could have offered them unconditionally unless the retirement board agreed, and that one could call that "contingent."

Mr. Romano asked Councilmember Madaffer if he remembered the "trigger" and the proposal to lower it, and Councilmember Madaffer replied that he did remember this but did not remember learning that the fiduciary counsel had concerns with this proposal. Councilmember Madaffer recognized that statements about the fiduciary counsel's concerns were on the second page of the June 14, 2002 memorandum (Exhibit 4), but replied that he didn't remember if he received this document in advance of the presentation or only as it began, and did not know if he had the chance to read it at all.

Mr. Schachter asked if there was an oral presentation that accompanied the June 14, 2002 memorandum, and Councilmember Madaffer replied that there probably was such a presentation. Mr. Schachter asked if Councilmembers ever got memoranda in advance of the presentations, and Councilmember Madaffer responded that they prefer to get them in advance and usually got them the Friday before Closed Session on Tuesday. Councilmember Madaffer noted that on fast-moving issues like labor negotiations, they would not receive information in advance, and he did not recall a briefing in advance of the June 14, 2002 presentation. Mr.



Schachter asked if he recalled anything that suggested that the City could only pay benefits if SDCERS agreed to change the contribution structure. Councilmember Madaffer replied that the City could offer benefits if SDCERS went along with management, and this was a good way of explaining the situation. Mr. Schachter asked if this meant the benefits were contingent on the SDCERS Board's agreement and Councilmember Madaffer replied that he did not use that word, but that the SDCERS Board would have to agree to modify the City's contribution structure. Mr. Turner asked why the benefits would not be contingent if the City couldn't offer them without contribution relief, and Councilmember Madaffer stated that one could describe the situation that way, but he had never thought of it like that before. He felt that SDCERS was an independent entity; the City was trying to solve the funding problem; and if the SDCERS Board accepted the City's proposal, then it could move forward.

Councilmember Madaffer was shown a letter from Ms. Shipione to Mayor Murphy and the City Council dated November 18, 2002, protesting the Council's approval of MP2 (Exhibit 5). Councilmember Madaffer recalled receiving this letter, and noted that her accusation that the footnote was inaccurate was not consistent with information the Council was given by other sources. Mr. Romano asked if Councilmember Madaffer recognized the handwriting on this document, and he replied that he did not. He stated again that Ms. Shipione had her opinion, and it was not shared by anyone else.

Mr. Romano noted that Ms. Shipione stated in her letter that there was something improper about putting this proposal before the retirement board and making it conditioned on the City granting benefits. Mr. Romano then asked Councilmember Madaffer if he recalled his reaction to this allegation, and Councilmember Madaffer replied that he found it troubling. Mr. Romano asked if Councilmember Madaffer thought this accusation had merit and he replied that he did not. Mr. Romano asked why, and Councilmember Madaffer explained that as a Councilmember, he heard testimony that day from the public, auditors, financial experts, and the City Manager, and all of them dismissed her concerns out of hand. He stated that he wanted to take allegations of impropriety seriously, but the great preponderance of opinions dismissed her concerns. In addition, Councilmember Madaffer explained that it was necessary to judge a person's character, and she seemed vindictive. Mr. Turner inquired as to Ms. Shipione's motive, and Councilmember Madaffer responded that he didn't know, but that it seemed to him as though something else was going on at the time.

Mr. Romano asked again whether there was a connection between benefits granted by the City and the SDCERS agreement, and Councilmember Madaffer replied that there was not; they were entirely independent. He recalled that in Closed Session, the City Manager and others admonished the Councilmembers not to talk to the SDCERS Board to ensure that there was no appearance of undue influence by the Council. Mr. Romano observed that Councilmember Madaffer held this opinion notwithstanding the reference to "contingent" on these documents, and he replied that this was correct.

Regarding Ms. Shipione's letter, Mr. Schachter asked if her testimony concerning these allegations was in open session. Councilmember Madaffer replied that it was, and that this was not the first time that the Council had heard from Ms. Shipione. Councilmember Madaffer then stated that it might have been the first time Ms. Shipione spoke to the Council, but he viewed her as someone who lost a vote to the majority on the SDCERS Board and was expressing a minority opinion. Mr. Schachter asked if Councilmember Madaffer recalled

meetings regarding Ms. Shipione's allegations outside of open session and Councilmember Madaffer replied that he did not.

Councilmember Madaffer was then shown an email from Councilmember Byron Wear to Cathy Lexin, Councilmember Madaffer and others, dated June 23, 2002, which instructed Cathy Lexin to be prepared to explain why she advised the Council to "go down this policy path" without "some degree of assurance...from the Retirement Board in advance" (Exhibit 6). Mr. Romano asked Councilmember Madaffer to read this email and asked what Mr. Wear was saying Ms. Lexin should have done differently. Councilmember Madaffer replied that he remembered receiving this email, and felt like Mr. Wear was upset that she did not "have her ducks in a row with respect to the trigger." Mr. Romano asked him to explain the "policy path" referred to in the email, and he replied that this referred to Meet & Confer. Mr. Romano then asked about the phrase "timing and assurance in advance," and Councilmember Madaffer responded that this phrase would certainly suggest a contingency.

Councilmember Madaffer was then shown the minutes from the Council's November 18, 2002 session (Exhibit 7). Mr. Romano asked if this was the form in which the minutes were maintained, and Councilmember Madaffer replied that the minutes were usually prepared about a month or so after the meeting to which they refer. Mr. Romano confirmed that Items 50 and 51 in the minutes implemented MP2 and Councilmember Madaffer agreed. Mr. Romano then asked why it was necessary to indemnify the SDCERS Board at that time. Councilmember Madaffer replied that the pension board requested indemnification, and that looking back he had a different perspective. Mr. Romano asked if there was discussion about whether this was necessary or whether it was already addressed by state law, and Councilmember Madaffer responded that there was no such discussion.

Councilmember Madaffer then stated that the Manager's Supporting Information on page 40 of the November 18, 2002 minutes justified the grant of indemnification. It appeared at the interview as if Councilmember Madaffer had mistakenly believed that certain portions of the Manager's Supporting Information which dealt with Employer Contributions actually addressed Board Indemnification instead. At this point, Councilmember Madaffer's lawyer helped explain his error to him. Moving on, Councilmember Madaffer offered his speculation that the reason the Board was uncomfortable entering into MP2 was because they were threatened with lawsuits from Michael Aguirre, who was a private lawyer at the time. Mr. Romano asked if he recalled anyone telling him this at the time, and Councilmember Madaffer could only recall that there was a potential threat of litigation against the retirement board.

After a fifteen-minute break, Councilmember Madaffer stated that he wanted to expand on his comments regarding the contingent nature of the benefits granted by MP2. He explained that the salary ordinance resulting from a Meet & Confer process is usually passed by May. He stated that there is no contingency with the retirement board, but that the contingency is only if the Board does not accept the proposal. In his view, the salary and wages are negotiated by May and are settled, and then the Council turns to retirement issues. He noted that it was Ms. Lexin who described benefits as "contingent," not him, and stated that by the time of her memorandum dated June 14, 2002 (Exhibit 4), benefits were already negotiated.

Mr. Romano then asked him whether the benefits would have been granted if the retirement board refused to approve MP2. Councilmember Madaffer replied that the benefits

were separate and they were set; the trigger issue was dealt with later. Mr. Romano asked if he thought that benefits were going to be paid no matter what happened later, and Councilmember Madaffer said this was true. He repeated that Ms. Lexin's June 14, 2002 memorandum (Exhibit 4) was her interpretation and not necessarily an accurate description of what took place. Mr. Turner asked if MP2 granted significantly increased benefits and Councilmember Madaffer replied that benefits increased, but he would not call it a "significant" increase.

Mr. Turner noted that earlier Councilmember Madaffer mentioned that he was surprised to learn of the underfunding described in the BRC Report, but then in November 2002, he agreed to not fully fund the pension system. Mr. Turner asked Councilmember Madaffer to explain his thoughts during the MP2 process. Councilmember Madaffer explained that MP2 took into account the underfunding and gave the City time to start paying larger amounts in future years. He described the plan as "prudent" and "cautious," because it allowed the City to better anticipate the need to pay increased contributions in future years. Mr. Turner asked if he realized at the time that MP2 deferred contribution payments to future taxpayers, and Councilmember Madaffer stated that he did realize this, but that MP2 was sensitive to managing money and "good fiscal management."

After another break, Mr. Romano noted that the second page of Ms. Lexin's June 14, 2002 memorandum (Exhibit 4) stated that MP2 increased the contribution rate .5% a year, which was less than the actuarially-determined rate. He asked Councilmember Madaffer what exactly this rate increase accomplished. Councilmember Madaffer responded that his understanding was that the doubling of the rate increase took care of the underfunding issue. He acknowledged that this view was not consistent with Ms. Lexin's June 14, 2002 memorandum, but stated that other documents or presentations he received clearly stated that MP2 would correct the underfunding. Mr. Romano asked if he later understood that view to be inaccurate, and Councilmember Madaffer stated that at the time of the interview he believed the information he was given was not accurate.

Councilmember Madaffer was then shown a letter from Michael Aguirre to the SDCERS Board, dated June 20, 2002, which threatened litigation if the retirement board agreed to MP2 (Exhibit 8). Mr. Romano asked Councilmember Madaffer if he had ever seen this document and Councilmember Madaffer replied that he did not recall. Mr. Romano asked if he remembered the threat of litigation around this time, and Councilmember Madaffer stated that he did because on November 18, 2002, Ms. Shipione testified that Mr. Aguirre had threatened the retirement board with litigation concerning the proposal to reduce the trigger to 75%. Councilmember Madaffer then noted that after the proposal to reduce the trigger to 75% was removed, but while he was still a private attorney, Mr. Aguirre came to a Rules Committee meeting and praised the Council, stating that any problems with the retirement system were caused by prior City Councils. Councilmember Madaffer believed that Mr. Aguirre had made money from pension fraud cases and saw this vote as an opportunity to profit.

Councilmember Madaffer remembered that in November 2002, Ms. Shipione handed out a letter that Assistant City Manager Lamont Ewell responded to towards the end of that year. Councilmember Madaffer remembered calling Ms. Shipione at her home around this time and asking her to walk him through her letter. He also remembered that she wanted an outside audit of SDCERS. Councilmember Madaffer stated that Ms. Shipione was the only

SDCERS Board member who seemed to have any concern about these issues. Councilmember Madaffer stated that he did not know anything about Mr. Vortmann at that time.

Councilmember Madaffer was next shown a memorandum from Assistant City Manager Lamont Ewell to the Mayor and Council dated December 6, 2002, in which Mr. Ewell responded to the allegations of Ms. Shipione regarding MP2 (Exhibit 9). Mr. Romano asked if Councilmember Madaffer recalled reading this memorandum at the time, and Councilmember Madaffer replied that he did. He did not know why Mr. Ewell was assigned the task of responding to Ms. Shipione, and thought that Mr. Ewell had probably not been in his position as Deputy City Manager long by that time. Mr. Romano asked if Mr. Ewell had researched these issues thoroughly or if this memorandum was mere advocacy. Councilmember Madaffer replied that it was hard to determine. He did not know Mr. Ewell's practice, but thought that he was "honest and reputable." Councilmember Madaffer did not think that this was advocacy, but he did not discuss this with Mr. Ewell and did not recall discussing it with other Councilmembers.

Issue #2, located on page 3 of this document, reads "Ms. Shipione asserts that 'promising a city employee benefit conditioned upon a separate fiduciary's approval of an agreement to reduce already deficient City contributions to its pension plan is ethically questionable at best, if not blatantly corrupt.'" Mr. Romano asked if Councilmember Madaffer believed that any part of that statement was inaccurate other than possibly "questionable" and "corrupt." Councilmember Madaffer replied that he did not agree with this statement. He believed that Ms. Shipione reinvented the world in her own mind, and did not see what actually happened. Mr. Schachter then stated that these explanations imply that Ms. Shipione simply got lucky with her allegations. Councilmember Madaffer replied that it was correct to say she "got lucky." He stressed that countless people advised the SDCERS Board and that he was elected to be a decision-maker, not an accountant or actuarial expert. He had to make his decisions based on the weight of evidence he was given and Ms. Shipione made allegations without relying on facts. Mr. Turner asked if he viewed her as a whistleblower, and he replied that he did now, but at the time he viewed her as a bitter person who lost a vote and wouldn't relent. Mr. Turner asked if anyone at the time viewed her as a whistleblower and sought to investigate her accusations. Councilmember Madaffer replied that no one said at the time that she was a whistleblower and that no investigation was launched because the City was more trusting back then. When one person voiced a concern but everyone else disagreed, that was the extent of the investigation.

Mr. Schachter asked if anyone in the Mayor's Office might have influenced Mr. Ewell's response to Ms. Shipione's November 18 letter and Councilmember Madaffer replied that "everyone's job is to influence the City Manager." Mr. Schachter asked if there was a general practice regarding attempts by the Mayor to influence the City Manager and Councilmember Madaffer replied that there was not. The Mayor had more interaction with the City Manager than the Council did, and certain Councilmembers had more interaction with the City Manager than others. Mr. Schachter asked whether any Councilmembers had more involvement in labor issues than others, and Councilmember Madaffer responded that the entire Council dealt with labor issues, in Closed Session. Councilmember Madaffer stated his belief that Mr. Ewell's December 6, 2002 letter (Exhibit 9) was driven by the City Manager's Office.

Councilmember Madaffer was then shown a letter from Ms. Shipione to Mr. Ewell dated December 31, 2002 (Exhibit 10). This document contains handwriting in the

margins, and Councilmember Madaffer immediately recognized the handwriting as his own. Mr. Romano noted that Ms. Shipione's assertions seem to be factual in nature, and if credited, should have carried weight. He asked Councilmember Madaffer if he viewed her as someone to be dismissed. At this point, Councilmember Madaffer's lawyer, Thomas Zaccaro, instructed him to describe how his view of her changed over time. Mr. Romano then asked Councilmember Madaffer to recall his view of her on December 31, 2002. Councilmember Madaffer responded that he thought she was bitter because of losing the vote on the SDCERS Board. Looking back, he wondered why she delivered her November 18, 2002 letter at the Council meeting rather than a week earlier. Councilmember Madaffer mentioned that Ms. Shipione's husband, Pat Shea, had just lost the Bromfield Aviation deal and was angry, and that he felt Ms. Shipione had a political axe to grind as a result. Mr. Romano asked if her November 18, 2002 letter was an attempt to embarrass anyone and Councilmember Madaffer called it a "hit piece." He stated that Pat Shea was "embedded" in the City Attorney's Office and continued to retaliate for having lost the Bromfield deal. Mr. Zaccaro then interjected that if one viewed the tape of the November 18, 2002 Council session, it would be clear that Ms. Shipione stood alone in her objections. Councilmember Madaffer added that she just did not have credibility.

Mr. Turner asked Councilmember Madaffer to describe the situation surrounding Pat Shea and the Bromfield deal. Councilmember Madaffer noted that he brought up this issue only "tangentially," since it was not a proven fact, and at the time he had not connected the Bromfield issue to Ms. Shipione's comments. He explained that Mr. Shea was involved in a development plan to turn Bromfield Airport into a commercial cargo port. This was a large plan, involving hundreds of millions of dollars, and Mr. Shea had left a position as manager of a different firm to manage this development plan. The plan had already started to weaken when Councilmember Ralph Inzunza and another person involved in development issues started a television lobbying campaign to encourage voters to reject this project. Councilmember Madaffer noted that Mr. Shea continued to be upset about the failed project. Mr. Turner asked if there was a conflict between Mr. Shea and Mayor Murphy; Councilmember Madaffer replied that they used to be friends and that the Mayor performed the wedding between Mr. Shea and Ms. Shipione. Councilmember Madaffer suggested that at the beginning of the Bromfield project, Mr. Shea probably assumed that he had the Mayor's support, but the project was eventually defeated by Councilmember Inzunza's lobbying. Councilmember Madaffer heard a rumor that Mr. Shea was on a crusade to even the score.

Returning to the Shipione allegations, Councilmember Madaffer stated that there were assertions in her letters that proved accurate but that he still believed them to be fixable, and that she made other allegations with which he still does not agree. Specifically, she used the term "backroom deals," and Councilmember Madaffer stated that he resented this accusation and noted that she was not present during the meetings she spoke of. Councilmember Madaffer acknowledged that the handwriting on this Exhibit was all his, and that any apparent discrepancies in the handwriting were due to the fact that he wrote with different pens at different times. Councilmember Madaffer pointed Mr. Romano to page 7 of the Exhibit where he wrote "I wish I had voted no," and stated that this writing was from around January 3, 2003, the date stamped on the letter. Mr. Romano asked him to explain this comment, and he replied that it meant he wished he had voted against MP2. Mr. Romano asked if that comment was a response to reading this letter, and Councilmember Madaffer stated that it was. Councilmember Madaffer explained that after he received Ms. Shipione's December 31, 2003 letter, he began to

think about her allegations differently, so he called her at home to discuss her letter. He noted that during this phone call she persuaded him of the underfunding problem and the need for an independent audit. He suggested that if she had initially brought these issues to his attention at a different time, he might have been more skeptical of the Council's actions, but that he was only as good as the information he was given.

Councilmember Madaffer was next shown a memorandum from City Manager Michael Uberuaga to Councilmember Madaffer and Councilmember Frye dated May 5, 2003, regarding Councilmember Madaffer's request for an independent audit of SDCERS (Exhibit 11). Mr. Zaccaro explained that Councilmember Madaffer first asked for an audit during a February 12, 2003 meeting with SDCERS, which request was then put in the form of a motion and adopted. Mr. Romano asked Councilmember Madaffer to explain the audit that is referenced in the memorandum. Councilmember Madaffer replied that after his phone call with Ms. Shipione, he returned to the Rules Committee, discussed the underfunding and requested an audit. Mr. Turner asked him to specify who would have performed the audit and what exactly they would have audited. Councilmember Madaffer stated that he did not specify these details; he was just looking for third-party validation and credibility of the system. He wanted to investigate whether there were deals and illegal benefits, and wanted an auditor to confirm that things were done legally and the representations that the Council received were valid.

After another break, Councilmember Madaffer produced a document: an April 24, 2003 memorandum expressing his support for an audit (Exhibit 12). Councilmember Madaffer explained that this was sent to follow up on a memorandum by Councilmember Frye for an audit, and he wanted to be on the record in support. He noted that the Council acted on these requests by creating the Pension Reform Committee. Mr. Romano asked if Councilmember Madaffer was concerned enough by this time about the financial well-being of the pension system that he wanted an audit, and Councilmember Madaffer replied that this was correct.

Moving forward, Mr. Romano asked Councilmember Madaffer to explain what happened next to address the pension issue. Councilmember Madaffer stated that he could not recall additional steps taken in 2003, and noted that the Council was under the impression that MP2 addressed this issue. The Council was told that MP2 doubled the City's contribution rate and considered MP2 "corrective action." He felt that if the pension board or other experts had a problem they could have raised it, but everyone seemed comfortable with the City's actions.

### *Presidential Leave*

Mr. Romano began the discussion of presidential leave benefits by asking if Councilmember Madaffer recalled this issue coming up during the 2002 Meet & Confer process. Councilmember Madaffer replied that this issue was discussed at that time, and that the firefighters union did not have presidential leave and wanted to receive this benefit along with the other unions who already had it. Councilmember Madaffer described this as an "equity issue," and noted that it seemed to have been a simple request. His understanding of this benefit was that while an employee was serving as a president of a union, he would receive pension benefits equal to those of the Labor Relations Director. Councilmember Madaffer was the person who proposed that benefits granted under presidential leave be "pegged" to the salary of then-Labor Relations Director Dan Kelley, as a way to prevent the presidential benefits from getting "out of control."

Mr. Romano asked how the employer contributions would have been made for this benefit, and Councilmember Madaffer noted that an IRS issue arose after the initial approach of having employer contributions made by the unions. Mr. Romano asked if he recalled that some component of Firefighters Union President Ron Saathoff's benefit was retroactive, and Councilmember Madaffer replied that he was unaware of this fact. Mr. Romano showed Councilmember Madaffer an agreement between the City and Mr. Saathoff concerning retirement benefits (Exhibit 13). Mr. Romano again asked if he knew about retroactive retirement benefits and Councilmember Madaffer replied that he did not, and did not recall having seen this document before.

### *Purchase of Service Credits*

Mr. Romano asked if Councilmember Madaffer had an understanding of the Purchase of Service Credit ("PSC") program, and Councilmember Madaffer replied that he did and that the program allowed City employees to purchase up to five years of creditable service time at a rate set by the retirement board. An employee pays into the system and the system pays the employee back based on its investment returns. Councilmember Madaffer was not aware of how the retirement board sets the rates for these credits. Mr. Romano asked if he knew that the purchased years could be used to reduce the vesting period from ten to five years, and Councilmember Madaffer replied that he guessed this was one way it could be used, but was not aware of this until recently. Mr. Romano asked if, at the time the Ordinance was adopted, he recalled a discussion about an inconsistency between this program and the City Charter. Councilmember Madaffer responded that he was not aware of when this benefit was voted upon and only became aware of it when he was ending his service as Chief of Staff for Councilmember McCarty in 2000. Mr. Romano asked if he had purchased credit under this program, and he replied that he did, in December 2001.

Councilmember Madaffer was shown an email from SDCERS Administrator Lawrence Grissom to Vincent Hayes dated November 26, 2001, regarding the purchase of service credits (Exhibit 14). Mr. Romano asked if Councilmember Madaffer knew Mr. Hayes, and Councilmember Madaffer responded that they had met. Mr. Romano asked if he remembered the conversation with Mr. Hayes that was referenced in the document. Councilmember Madaffer did remember this conversation, but disagreed with the reference in the document to a meeting between himself and Mr. Grissom. Councilmember Madaffer stated that he did not talk to Mr. Grissom about these benefits, and that he only met Mr. Grissom before he was a Councilmember, when he was discussing Councilmember McCarty's retirement.

The document refers to a conversation between Councilmember Madaffer and SDCERS President Fred Pierce and his Mr. Pierce's wife, in which Mr. Pierce told him to "purchase his five years right away." Councilmember Madaffer remembered that Mr. and Mrs. Pierce explained the PSC pricing to him and told him he should purchase at that point, and he did purchase five years about a week later at a cost of approximately \$50,000. Mr. Romano asked Councilmember Madaffer to explain what he was told about the pricing, and he replied that the price of service credits are based on one's salary, so it was beneficial to purchase credits before one's salary was raised. Mr. Romano asked if Councilmember Madaffer could have vested early, and he responded that he had seven years of service as Chief of Staff and three years as Councilmember, in addition to his five purchased years.

### *Wastewater Issues*

At this point, Mr. Schachter began to question Councilmember Madaffer about issues concerning the City's wastewater system, and gave Councilmember Madaffer two documents: an email from Councilmember Madaffer to Dennis Kahlie dated January 29, 2002, concerning a Closed Session meeting on that date (Exhibit 15) and the "Closed Session Report" for that meeting (Exhibit 16). Mr. Schachter stated that on January 29, 2002, Mr. Kahlie gave a presentation in Closed Session on the subject of changing wastewater rates to bring them into compliance, and asked if Councilmember Madaffer recalled that meeting. Councilmember Madaffer did recall the meeting, and remembered that Mr. Kahlie's presentation involved modifying rates based on a Cost of Service Study. Councilmember Madaffer did not recall the length of the presentation, but the thrust was that Kelco and restaurants would cost the system more than other types of users. Mr. Schachter asked if there was a proposal offered at this meeting, and Councilmember Madaffer could not recall a specific proposal being made.

Mr. Schachter stated that someone had asked the City Attorney's Office to analyze this issue, and Kelly Salt responded in a memorandum, dated November 14, 2002 (Exhibit 17). Mr. Schachter asked if this document refreshed Councilmember Madaffer's recollection about the presentation and he replied that it did. Councilmember Madaffer stated that the January 29 meeting must have been the first time that he had heard of this issue, but he could not recall whether the legal requirements in the Salt memorandum were mentioned in Mr. Kahlie's presentation.

Mr. Schachter asked if Councilmember Madaffer was ever informed that the City needed to change its rate structure in order to avoid the acceleration of grant and loan repayment. Councilmember Madaffer did not recall whether this reason was given, and was not aware of why the City should have changed its rates. Mr. Schachter asked if the City was supposed to raise rates, or just change the allocation between residential users on one hand and Kelco and the restaurants on the other hand. Councilmember Madaffer replied that it was a combination of these approaches; there was an interest in raising rates and allocation was a policy issue on which the Council wanted a better analysis of the legal requirements. Councilmember Madaffer noted at this point that in 2002, most of the Councilmembers were recently elected.

Mr. Schachter then asked about the effect a new rate structure might have had on Kelco and restaurants. Councilmember Madaffer responded that from an economic development point of view, the City was trying to be as competitive as possible within the region and state to keep industry in the City. Mr. Schachter asked why a changed rate structure would effect these interests, and Councilmember Madaffer replied that it was because commercial users contributed more bio-solids to the system.

Mr. Madaffer was shown an email he wrote to Dennis Kahlie dated January 29, 2002, titled "Cost of Service Matter" (Exhibit 15). Mr. Schachter asked Councilmember Madaffer about his comment that "we can't say we weren't given a fair warning." Councilmember Madaffer replied that it was difficult to say what this comment referred to, and that he did not recall a warning from Mr. Kahlie. Councilmember Madaffer suggested that it might have been referring to compliance, but he did not remember it that way. Mr. Schachter asked if it might have referred to a risk for the City that grant and loan repayment might have been accelerated, but Councilmember Madaffer did not recall being told this, and described the issue as a policy call for



the Council. Mr. Schachter asked Councilmember Madaffer if he was particularly hard on Mr. Kahlie at this meeting, and he replied that it would not have been unlike him because he is fairly demanding of staff.

Mr. Romano asked if Councilmember Madaffer had an opinion on whether Mr. Kahlie was competent and reliable, and Councilmember Madaffer called him a "a city worker." Mr. Romano asked if Mr. Kahlie's position was consistent with the Salt memorandum (Exhibit 17), and Councilmember Madaffer replied that Mr. Kahlie's presentation dealt with changing allocation and user rates, which Councilmember Madaffer thought would penalize the low-volume user. He did not recall the presentation dealing with compliance with state and federal requirements. Mr. Schachter asked what warning was given by Mr. Kahlie, and Councilmember Madaffer replied that the warning was that the City was not in compliance with some requirement, but that he did not connect that presentation with grant and loan requirements until now. He noted that no one, including the City Attorney, ever told him that the City had to make these changes. Councilmember Madaffer did not recall what Mr. Kahlie indicated the consequences would be of continued noncompliance, and did not recall him discussing grants and loans in the January 29 presentation.

Mr. Schachter asked if Councilmember Madaffer recalled an open session in mid-2002 where Councilmember Frye asked for a Cost of Service Study and was told not to discuss this issue. Councilmember Madaffer recalled this request, but did not recall a request to make this study public, or why the study might not have been made public initially. Mr. Schachter asked why this matter was removed from the Council agenda after this meeting, and Councilmember Madaffer did not know why this occurred.

Councilmember Madaffer was shown a memorandum from Assistant City Attorney Les Girard to Councilmember Frye dated November 18, 2002, regarding the Cost of Service Study (Exhibit 18). Councilmember Madaffer stated that he had not seen this document before, and had only a vague recollection that this issue was tied to rate increases. He noted that Proposition 218 limited the City's ability to raise fees, and there might have been a comment made that changing the rate structure would have raised fees. Mr. Schachter asked if he recalled receiving the Salt memorandum (Exhibit 17), and he replied that it looked like the type of materials that were presented in Closed Session briefings. Mr. Schachter asked if Councilmember Madaffer had a recollection today of learning the information contained in this memo concerning the City's noncompliance and risk of accelerated repayment, and Councilmember Madaffer responded that he could not say for certain whether he had seen this document before or not, and did not recall the Cost of Service Study having to do with grants and loans, just the rates of industry and restaurants.

Councilmember Madaffer was shown a memorandum from Mr. Ewell to the Mayor and Council dated November 22, 2002, attaching a draft Cost of Service Study performed by Black & Veatch (Exhibit 19). Mr. Schachter asked if Councilmember Madaffer recalled seeing this memo, and he replied that he could not say for sure, but that he had heard of the Black & Veatch Report. Mr. Schachter asked him about his understanding of the Black & Veatch Report, and Councilmember Madaffer recalled that it referenced a Cost of Service Study, but did not recall when he had heard about this Report. He did recall Mr. Kahlie discussing this Report, but did not recall if this Report concluded that the City was obligated to change its rates.

Councilmember Madaffer was then shown an email from Councilmember Madaffer to his staff dated September 25, 2003, which referenced the Cost of Service Study (Exhibit 19). Mr. Schachter directed Councilmember Madaffer to the section of the email that referenced the study and asked if he recalled sending this email. Councilmember Madaffer did not recall sending this email, but thought that it must have related to the Natural Resources & Culture Committee. Councilmember Madaffer stated that he was the Chair of the Natural Resources & Culture Committee and he decided which items made it to the Committee agenda. Mr. Schachter asked him what direction he was giving his staff on this matter, and Councilmember Madaffer replied that he was not interested in docketing this issue because it was geared to raise rates on businesses. To Councilmember Madaffer, this issue was about remaining competitive with other jurisdictions.

Mr. Schachter asked if he recalled at the time of this email that the need to change the rate structure was due to grants and loans, and he replied that he did not recall. Mr. Schachter then asked if he recalled any meetings about waiting for the state to sue the City, and Councilmember Madaffer replied that this comment sounded like something he would say. At this point, Mr. Zaccaro asked him if he actually recalled making this comment, and Councilmember Madaffer stated that he may have, but he could not recall. Mr. Schachter asked again why the City was considering changing its rate structure and Councilmember Madaffer stated that he could not recall a requirement for changing the rate structure.

Mr. Schachter then directed Councilmember Madaffer to examine the Black & Veatch Report (attached to Exhibit 20), specifically the second paragraph of the executive summary. Mr. Schachter again asked if Councilmember Madaffer had any recollection prior to this interview of hearing about the need to change rates to comply with state and federal grant and loan requirements. Councilmember Madaffer replied that he did not recall hearing this, and that his recollection was that the Cost of Service Study would have assigned a higher rate to those businesses like Kelco or restaurants that put more bio-solids into the system.

Mr. Schachter asked if Councilmember Madaffer knew of anyone who received political contributions from Kelco, and he responded that he did not. Mr. Schachter asked if Councilmember Madaffer himself received contributions from Kelco, and he responded that he did not know that either. Mr. Schachter asked if he recalled any political official being a particular supporter of Kelco. Councilmember Madaffer responded that he could not recall anyone off the top of his head, and that his recollection of the issue was that the Chamber of Commerce and other industry groups had an interest in the issue of wastewater rates. Unless the City Attorney's Office told him that the rates needed to change, this was a policy decision for the City.

Mr. Schachter asked if he recalled the City changing the rate structure, and Councilmember Madaffer replied that he did. Mr. Schachter asked why the City changed the rates, and he responded that it was to make capital improvements. Mr. Schachter asked if the reason was because the State Water Resources Control Board had set a date for compliance. Councilmember Madaffer did recall that the City needed to make capital improvements to meet the requirements of a compliance order.

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